

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:04

PLR-128487-07

Date: DECEMBER 14, 2007

In Re:

Legend

Decedent	=
Granddaughter	=
Trust	=
Bank	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Year X	=
Year Y	=
State	=
State Statute 1	=
State Statute 2	=
State Statute 3	=
State Statute 4	=
State Statute 5	=
Citation	=

Dear

This is in response to your authorized representative's letter, dated June 13, 2007, requesting rulings under §§ 2601 and 2501 of the Internal Revenue Code.

The facts as represented are as follows:

Decedent died testate on Date 1, prior to September 25, 1985. Pursuant to Decedent's will, dated Date 2, and subsequent codicils, Trust was established for the benefit of Granddaughter. Trust was funded using assets received from Decedent's estate, including certain mineral interests. It is represented that no additions, actual or constructive, have been made to Trust since its inception.

Item Seven of Decedent's will provides that after payment of all taxes, charges and expenses attributable to the Trust, the Trustee shall pay the net income to Granddaughter for and during her natural life in convenient periodical installments throughout each year as she may direct. Upon the death of Granddaughter, the Trustee is directed to distribute the corpus of Trust to the lineal descendants of Granddaughter, per stirpes, and, if none, to various charitable organizations.

Trust is administered under the laws of State. Pursuant to State Statute 1, as in effect during the years at issue, a trustee shall administer a trust with due regard for the interests of income beneficiaries and remaindermen with respect to the allocation or receipts and expenditures by crediting a receipt or charging an expenditure to income or principal or partly to each in accordance with the terms of the trust instrument or, in the absence of any contrary terms of the trust instrument, in accordance with the statute.

State Statute 2, as in effect during the years at issue, provides that income is the return derived from the use of principal, including receipts from disposition of natural resources.

State Statute 3(a), as in effect during the years at issue, provides that if part of the principal consists of a right to receive a royalty, overriding or limited royalty, working interest, delay rental, or other interest in minerals, or other natural resources (other than timber) in, on, or under land, the proceeds of the right shall be allocated to principal and income in accordance with the statute. State Statute 3(d) provides that if the proceeds are received as a royalty, overriding or limited royalty, or bonus or from a working interest, net profit interest, or any other interest in minerals or other natural resources, proceeds not provided for in State Statute 3(b) or (c) shall be apportioned on a yearly basis whether or not any natural resources were being taken from the land at the time the property was placed in trust. Twenty-seven and one-half percent of the gross proceeds, but not to exceed 50 percent of the net, after deducting the expenses and carrying charges on the property, is principal, and the balance is income.

Trust is silent as to the treatment of disbursements derived from mineral receipts, and State Statute 3(b) and (c) do not apply to the proceeds at issue in this case.

On Date 3, following a merger and acquisition, Bank became Trustee of Trust. From Date 3 to Date 4, pursuant to State law, Bank allocated 27.5 percent of mineral receipts to the corpus of Trust. However, from Date 3 through Date 4, the Schedule K-1, Beneficiary's Share of Income, Deductions, Credits, Etc., prepared by Bank, reported that all of the mineral receipts were allocated to income and distributed to Granddaughter. In each year, the Schedule K-1 was filed with Trust's Form 1041, U.S. Tax Return for Estates and Trusts, and was issued to Granddaughter. Because of the errors on the Schedules K-1, Granddaughter included all of Trust's mineral revenue in calculating her personal federal income taxes for each year.

The errors on the Schedules K-1 were discovered in Year X by a new certified public accountant (CPA) retained by Trustee to prepare the Year Y income tax return for the Trust. The CPA notified Trustee and, later, Granddaughter of the errors in the previous years. Trust then filed an amended Form 1041 for its tax year ending on Date 4.

Pursuant to State Statute 4, a person must bring suit on an action for breach of fiduciary duty not later than 4 years after the day that the cause of action accrues. The State Supreme Court has specifically stated that the statute of limitations in favor of a trustee does not begin until the beneficiary is notified of a "repudiation of the trust." Citation. On Date 5, Granddaughter asserted her right of recovery for reimbursement from the Trust of the amount of excess federal income taxes she paid during the relevant time period due to the erroneous Schedules K-1 issued by Bank as Trustee. Trustee has agreed to reimburse Granddaughter for the amount of income tax that she erroneously paid, plus interest at the applicable § 7520 rate as applied from time to time. Such reimbursement will be distributed from Trust principal. The Trustee has the power to make such distribution under State Statute 5, which provides that a trustee may compromise, contest, arbitrate, or settle claims of or against the trust estate or the trustee.

The following rulings are requested:

1. The inadvertent payment by Granddaughter of income taxes on mineral receipts that were, in fact, allocated to principal and not distributed to her does not constitute an addition to the Trust for generation-skipping transfer (GST) tax purposes where Granddaughter has a right of recovery from the Trust, has exercised her right, and the Trustee, in fact, reimburses Granddaughter in the amount of the overpayment, plus interest.

2. The inadvertent payment by Granddaughter of income taxes on mineral receipts that were, in fact, allocated to principal and not distributed to her does not constitute a gift to the Trust for gift tax purposes where Granddaughter has a right of

recovery from the Trust, has exercised her right, and the Trustee, in fact, reimburses Granddaughter in the amount of the overpayment, plus interest.

Section 2601 imposes a tax on every generation-skipping transfer (GST) made after October 26, 1986. Section 2611(a) defines a GST to mean (1) a taxable distribution, (2) a taxable termination, or (3) a direct skip.

Under section 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax generally does not apply to any GST transfer made under a trust that was irrevocable on September 25, 1985. However, the tax does apply to a pro rata portion of any GST under an irrevocable trust if additions (actual or constructive) are made to the trust after that date. Under § 26.2601-1(b)(1)(ii)(A), any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in §§ 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in a grantor's gross estate under §§ 2038 and 2042).

Under § 26.2601-1(b)(1)(v)(C), where a trust that is not subject to the GST tax by reason of being irrevocable on September 25, 1985, is relieved of any liability properly payable out of the assets of such trust, the person or entity who actually satisfies the liability is considered to have made a constructive addition to the trust in an amount equal to the liability. The constructive addition occurs when the trust is relieved of liability (e.g., when the right of recovery is no longer enforceable).

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual.

Section 2511 provides that the tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) provides, in part, that as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete.

It is represented that Granddaughter has not waived her right of recovery, and the State statute of limitations has not preempted that right. Granddaughter has timely enforced her right to recovery against the Trust, and the Trust will reimburse her from the principal of the Trust. Accordingly, based on the facts submitted and representations made, we conclude that, under § 26.2601-1(b)(1)(v)(C), no addition to Trust has occurred as a result of Granddaughter's erroneous payment of additional income tax. We further conclude that Granddaughter did not make a gift to Trust when she erroneously paid the additional income tax because Granddaughter has enforced her right to recovery, and Trust has agreed to reimburse Granddaughter.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or reference in this letter. Specifically, no opinion is expressed or implied with respect to any Federal or state income tax liability of Trust or Granddaughter during the period of time referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Katherine A. Mellody
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: Copy for § 6110 purposes